FOR ARGUMENT

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Supreme Court of the United States

OCTOBER TERM, 1979

No. 78-1201

MOBIL OIL CORPORATION,

Appellant,

—VS.—

COMMISSIONER OF TAXES OF VERMONT,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF VERMONT

APPELLANT'S REPLY BRIEF

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APPELLANT'S REPLY BRIEF

I.

The Foreign Dividends at Issue Are Not Includible in the Vermont Apportionable Base, Even If It Should Be Assumed That the Corporations Which Paid the Dividends Were Part of a Unitary Business.

A. *Since Vermont Apportioned Mobil's Income on a Separate Company Basis Without Taking Into Account the Apportionment Factors of the Foreign Dividend Paying Corporations, the Unitary or Non-Unitary Business Relationship of Those Corporations to Mobil Has No Bearing on the Constitutionality of Vermont's Apportionment.*

The question as to whether the subsidiaries and the other corporations from which Mobil received the foreign source dividends at issue were part of a unitary enterprise was not an issue at any stage of administrative or judicial

proceedings in this case, because that question is not relevant to the Vermont method of taxation and apportionment of dividends.[1] Nevertheless, the Commissioner and the *amici curiae* supporting Vermont's position contend before this Court that if the dividends did constitute part of a unitary business, there is no constitutional prohibition on their apportionment by Vermont, and that it was Mobil's burden to establish that the corporations that paid the foreign source dividends are not unitary.[2] We submit that this contention is without merit.

There are two basic but inconsistent approaches open to a State in allocating or apportioning the income of a multicorporate structured enterprise that constitutes a unitary business. A State may determine the income of the taxable corporation on a combined apportionment basis. Under that method the measure of the tax includes the income

[1] Mobil by no means concedes that the subsidiaries and affiliates from which it received the foreign source dividends at issue are part of its unitary business, as that term is used for State tax purposes.

[2] Thus in the brief filed by Standard Oil Company of California ("Socal") it is contended:

> "But whether the stock certificates* of the subsidiaries in question were 'held' or 'managed' by Mobil outside of the State of Vermont, or whether the earnings out of which the dividends were paid had a foreign or domestic 'source,' are irrelevant to the due process issue now before the Court, *because those 'facts' say nothing about the relationship of the stockholdings or the companies from which the dividends were paid to Mobil's integrated, unitary petroleum business* conducted within as well as without the State of Vermont."

See, also, the Commissioner's Br. pp. 16 *et seq.*

* Counsel for Socal have erroneously stated the facts. The Stipulation does not state that the "stock certificates" were "held, managed and controlled" outside Vermont; it states that the "capital stocks" were so handled, managed and controlled. Stip. ¶ 11, App. 83. The stipulation, of course, refers to Mobil's management of its interest in the corporations whose stock it held. See *North American Co.* v. *SEC*, pp. 18 to 19, *infra*.

of all corporations that comprise the unitary business, whether or not they are taxable by the State.[3] Likewise, the property, payroll, receipts or other factors of all the combined corporations are taken into account in reaching the percentage of the entire net income of the group to be taxed to the taxable corporation.[4] Dividends paid by one member of the combined group to other members are eliminated, along with other intercompany items, since the measure of the tax is limited to income derived by the unitary enterprise from dealings with non-members of the group.[5]

That is not the method prescribed under the Vermont statute or followed by the Commissioner in administering the Vermont tax, nor was it used in assessing the tax at issue against Mobil. If the combined method had been used, the dividends received by Mobil from any other corporations that were part of its unitary business would have been excluded from the tax base as an intercompany item; and the issue presented in this case would not have arisen.

Instead, Vermont uses, and applied in the instant case, a separate company apportionment. Under this method, the income of the taxpayer alone and only its own apportionment factors are taken into account. In accordance with this method, in assessing the tax at issue, the Com-

[3] See 1 "State Taxation of Interstate Commerce", Report of Special Subcommittee on State Taxation of Interstate Commerce, House Committee on the Judiciary, pp. 244-246 (88 Cong., 2d Sess., 1964); Rudolph, "State Taxation of Interstate Business: The Unitary Business Concept and Affiliated Groups", 25 Tax L.Rev. 171, 194-200 (1970); Altman & Keesling, Allocation of Income in State Taxation, 174 *et seq.* (2d Ed. 1950); Keesling & Warren, "The Unitary Concept in the Allocation of Income", 12 Hastings L.J. 42, 59 *et seq.* (1960).

[4] *Ibid.*

[5] See Rudolph *op. cit.* note 3 *supra*, 25 Tax L.Rev. at 200; Keesling & Warren *op. cit.* note 3 *supra*, 12 Hastings L.Rev. at 60.

missioner included in the measure of the tax assessed the income of Mobil alone as a separate company.[6] Likewise, the Commissioner apportioned Mobil's income on the basis of the property, payroll and receipts of Mobil alone as a separate company, without taking into account the factors of any companies whose dividend payments are at issue, which would all have been included in the denominators but not the Vermont numerators of the factors.[7] The separate company apportionment used by Vermont is the method employed by most States in taxing the income of multicorporate enterprises.[8]

In this case, therefore, the existence or non-existence of a unitary relationship between Mobil and corporations which paid the foreign source dividends at issue is irrelevant. Vermont's power to tax Mobil's foreign source dividends under the restraints on extraterritorial State taxation imposed by the Due Process Clause of the Fourteenth Amendment must be decided in the light of the method of taxation used by Vermont, not some other method that might have been employed, particularly where, as here, the tax results would differ.[9] That the State might be

[6] In Mobil's Vermont income tax returns for the years at issue, the apportionment was made by reference to the income and apportionment factors of Mobil alone. App. Ex. 1, 2 and 3, pp. A32-A73. In auditing the returns and making the assessment, no change was made by the Commissioner in the determination of Mobil's income and apportionment on a separate company basis. Determination of Appeal, J.S. App. A, 1a, 2a-3a.

[7] *Ibid.*

[8] See "Industry Statement on Proposed Interstate Tax Legislation", Hearings on State Taxation of Interstate Commerce, Subcommittee on State Taxation of Interstate Commerce, Senate Committee on Finance, pp. 260, 280-281 (93rd Cong., 1st Sess., Sept. 18-19, 1973).

[9] This principle may be illustrated by two cases, one involving a sales tax and the other a use tax, decided by this Court on the

(Footnote continued)

empowered to apportion Mobil's income on a combined basis with the corporations whose dividends are at issue, would afford no justification for including such dividends in the apportionable base on a separate company basis. The existence of a unitary relationship between corporations that are part of a multicorporate enterprise is a prerequisite to the use of combined apportionment,[10] but it adds nothing whatever to the State's constitutional power to include foreign source dividends in the tax base under the totally dissimilar separate company apportionment under which the Vermont tax was determined.

The question as to whether there is sufficient nexus between Vermont and Mobil's foreign source dividends to enable the State to include the dividends in the apportionable tax base must, therefore, be judged under the Due Process Clause by reference to Mobil's activities and operations in Vermont as a separate company, vis-a-vis the stocks and dividends in question. The record establishes

same day. In *McLeod* v. *Dilworth Co.*, 322 U.S. 327 (1944), the Court invalidated an Arkansas sales tax imposed on a Tennessee corporation based in Tennessee, which shipped goods from its Tennessee factory to customers in Arkansas, as a result of orders solicited by traveling salesmen, by mail or by telephone. In *General Trading Co.* v. *State Tax Commission*, 322 U.S. 335 (1944), on essentially the same factual pattern involving a Minnesota based vendor which shipped goods to customers in Iowa, as a result of orders obtained by traveling salesmen, the Court held that Iowa had the power to impose a use tax on the Iowa customers and to require the out-of-state vendor to collect the tax. In the *Dilworth* case, the court stated:

> "It is suggested, however, that Arkansas could have levied a tax of the same amount on the use of these goods in Arkansas by the Arkansas buyers, and that such a use tax would not exceed the limits upon state power derived from the United States Constitution. Whatever might be the fate of such a tax were it before us, the not too short answer is that Arkansas has chosen not to impose such a use tax. . . ." (322 U.S. at 330).

[10] See Keesling & Warren, *op. cit.* note 3 *supra passim*; Rudolph, *op. cit.* note 3 *supra*, 25 Tax L.Rev. at 183-184.

that the stocks were held, managed and controlled by Mobil from its offices outside Vermont. (Stip. ¶11, App. 83). Payment of all dividends was received by Mobil outside Vermont, and Mobil's control, use and disposition of such dividends were managed and directed from Mobil's offices outside Vermont. *(Ibid.)* The facts also show that none of the dividends taxed had their source in Vermont earnings, and that none of the corporations paying the dividends did business, or had any offices, employees or property in, or derived any income from, Vermont. (Stip. ¶25, App. 88). In the circumstance, the conclusion appears inescapable that the "definite link", the "minimum connection", that is a *sine qua non* for State taxation simply did not exist between Vermont and Mobil's foreign source dividends, and, accordingly, that the tax is repugnant to the Due Process Clause.[11]

B. *The Due Process Clause Does Not Sanction Inclusion in a Separate Company Apportionment of Dividends That Have No Connection With the Taxpayer's Own Operations and Activities in the State, Even If the Underlying Corporations Are Unitary With the Taxpayer.*

In challenging Mobil's Due Process contention, the opposing briefs place great emphasis on the fact that the Vermont tax is not imposed on the foreign source divi-

[11] One of the Commissioner's *amici* declares that Mobil seeks to apply "separate accounting" to the taxation of the dividends at issue (Multistate Tax Commission ["MTC"] Br. 35, 39). That is an erroneous statement. Mobil contends that *allocation* as distinguished from *apportionment*—not separate accounting—of the dividends is required. For definition of these terms, see Boren, "Specific Allocation of Corporate Income in California: Some Problems in the Uniform Division of Income for Tax Purposes", 30 Tax L.Rev. 607, 610-613 (1975). Counsel for the MTC should be familiar with the use of allocation, as distinguished from separate accounting, since allocation is used by the Uniform Division of Income for Tax Purposes Act ("UDITPA") for non-business dividents, interest, royalties and the like (see §§4-8, P-H State & Local Tax Serv. (hereafter referred to as "P-H") All States ¶91,409-A), and UDITPA is incorporated into the Multi-state Tax Compact. P-H All States, ¶6310.

dends, but that the dividends are included in the tax base apportioned under the statutory formula.[12] We are not oblivious to the distinction drawn in the cases between a tax on income or other tax measure and the use of such income or other measure as the base to which the apportionment formula is applied. Nevertheless, this point can be pressed too far, since the inclusion of a class of income in the apportionable tax base will usually increase the tax. The assertion that Vermont "merely" included the dividends in the apportionable base by no means ends the Due Process inquiry, contrary to the apparent position taken in at least one of the opposing briefs.[13] For this Court has held in a number of cases that the inclusion in the apportionable base of a tax of items lacking sufficient nexus to the State violates the Due Process Clause.

In *Union Tank Line Co.* v. *Wright* (249 U.S. 275, 286 [1919], the Court said:

> "In Fargo v. Hart, *supra*, we condemned an assessment ostensibly proportioned to mileage where property without the State and unnecessary to the Express Company's actual business had been included; and we pointed out that under no formula can a State tax things wholly beyond its jurisdiction."

Fargo v. *Hart* (193 U.S. 490 [1904]) dealt with an Indiana property tax on American Express Company. The

[12] Comm'r. Br. 13 *et seq.*; MTC Br. 37 *et seq.*; Socal Br. 6 *et seq.*

[13] ". . . the fact that the Vermont tax base, prior to apportionment, included dividend income from out-of-state properties and activities is totally irrelevant . . . To the extent dividend income is attributable to out-of-state properties and activities, this is reflected in a determination of apportionable income and the apportionment factors." MTC Br. 48.

It should also be observed that in making the assessment at issue, the Commissioner did not take into account the apportionment factors of the dividend paying companies. Nor were the dividends included in either the numerator or the denominator of the receipts factor of the apportionment formula.

assessment properly took into account the value of the good will and other intangibles used in the business in Indiana. The apportionment had been made under the "unit rule" (now termed the unitary business rule), using a line mileage formula. The taxpayer contended that the inclusion in the apportionable base of the tax of stocks, bonds and other securities in New York violated the Due Process and Commerce Clauses. The State sought to support the tax by contending that "the property [the securities] ought to enter into the valuation, because wherever situated it was used in the business; if not otherwise, at least as giving credit necessary for carrying the business on." (193 U.S. at 498). However, this Court after observing that the unit method:

> "may be made a means of unlawfully taxing the privilege, or property outside the State, under the name of enhanced value or good will, if it is not closely confined to its true meaning",

struck down the tax as "an attempt to tax property beyond the jurisdiction of the State, and to throw an unconstitutional burden on commerce among the States." (Holmes, J., 193 U.S. at 500, 502).

The same principle was applied to the apportionment of the capital stock of a railroad operating in several States under a North Dakota tax imposed on the privilege of doing business in the State. In *Wallace* v. *Hines* (253 U.S. 66 [1920]), the value of the railroad's capital stock was apportioned in the ratio of the company's track mileage in the State to its total track mileage. The taxpayer challenged the inclusion in the apportionable base of the value of the railroad's stocks and bonds. A preliminary injunction against the enforcement of the tax was sustained by a unanimous opinion of this Court, in which Mr. Justice Holmes stated:

> "The only reason for allowing a State to look beyond its borders when it taxes the property of foreign corporations is that it may get the true value of the things within it, when they are part of an organic system of wide extent, that gives them a value above what they otherwise would possess. *The purpose is not to expose the heel of the system to a mortal dart—not, in other words, to open to taxation what is not within the State.* Therefore, no property of such an interstate road situated elsewhere can be taken into account unless it can be seen in some plain and fairly intelligible way that it adds to the value of the road and the rights exercised in the State. Hence the possession of bonds secured by mortgage of lands in other States, or of a land-grant in another State or of other property that adds to the riches of the corporation but does not affect the North Dakota part of the road is no sufficient ground for the increase of the tax—whatever it may be—whether a tax on property, or, as here, an excise upon doing business in the State. St. Louis Southwestern Ry. Co. v. Arkansas, 235 U.S. 350, 364. In this case, it is alleged, the tax commissioner's valuation included items of the kind described to very large amounts. The foregoing considerations justify the preliminary injunction that was granted against what would appear to be an unwarranted interference with interstate commerce and a taking of property without due process of law. Fargo v. Hart, 193 U.S. 490. Union Tank Line Co. v. Wright, 249 U.S. 275, 282." (253 U.S. at 69-70; emphasis added).[14]

A recent opinion of this Court put the Due Process limitation on apportionment as follows:

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[14] *Accord: Southern Ry. Co.* v. *Kentucky*, 274 U.S. 76, 82-84 (1927); see *Illinois Central R.R.* v. *Greene*, 244 U.S. 555, 562-563 (1917).

> "... A State will not be permitted, under the shelter of an imprecise allocation formula or *by ignoring the peculiarities of a given enterprise*, to 'project the taxing power of the state plainly beyond its borders.' Nashville, C. & St. L. R. Co. v. Browning, 310 U.S. 362, 365 (1940). Any formula used must bear a rational relationship, both on its face and in its application, to property values connected with the taxing State." (*Norfolk & Western Ry. Co.* v. *Missouri State Tax Commission*, 390 U.S. 317, 325 [1968]; emphasis added.)

These cases and our contention are not at odds with the proposition stated in the cases relied on in the opposing briefs, that an apportioned tax "does not purport to identify the precise geographical source of a corporation's profits",[15] or that in imposing an apportioned tax on doing business the State may look "to the property of such corporations beyond its borders".[16] Those cases dealt with the inclusion of out-of-state income, property or other items of the taxpayer that were all integral parts of the business being apportioned on a unitary basis. The crucial difference between such cases and the instant case lies in the fact that the manufacture of ale in England and its sale in the United States in *Bass Ratcliff*, and the manufacture of animal foods in Illinois and their sale in Iowa in *Moorman* were all part of the enterprises whose income was apportioned on a unitary basis and that the property or receipts—i.e., the apportionment factors—in England and Illinois were taken into account in making the New York and Iowa assessments. Those cases would be relevant to

[15] *Moorman Manufacturing Co.* v. *Bair*, 437 U.S. 267, 273 (1978); Comm'r. Br. 12-13; MTC. Br. 38.

[16] *Bass, Ratcliff & Gretton* v. *State Tax Comm.*, 266 U.S. 271, 282 (1924); Comm'r. Br. 14-15; MTC. Br. 45-47.

the case at bar if Vermont had taxed Mobil as a component of a unitary business and had made the apportionment on a combined basis that took into account the income and factors of the foreign subsidiaries. But because Vermont has apportioned Mobil's income on a separate company basis, the integration or unity of the operations of Mobil's foreign subsidiaries and affiliates with the selling of gasoline and fuel oil and the like in Vermont cannot be used to justify the inclusion in the Vermont tax base of the dividends on such stocks.

Since, therefore, Mobil's foreign source dividends cannot be linked under the Due Process Clause with Vermont on the theory that the operations of the dividend paying corporations are unitary with Mobil's product sales in Vermont, there is no link between Mobil's dividend income and Vermont that justifies, under the Due Process Clause, the inclusion of the dividends in the apportionable tax base.

The Commissioner, however, contends that there may be other links between Mobil's foreign dividends and Vermont. He contends that it may be inferred that the foreign dividend income may have been used by Mobil to finance its daily operations in Vermont, to purchase or finance property in the State, to purchase or finance petroleum products marketed in Vermont, or otherwise benefit its business activities in the State. (Comm'r.'s Br. 17). The premise of this argument, that income may be taxed by a State or may be included in its apportionable base because, after it has been realized, the income is spent in the State, would push jurisdiction to impose corporate income taxes to an unprecedented and an unwarranted extreme. The entire concept of taxable income is that it is taxed as it is received or accrued, and its taxability is determined at that

point.[17] Once the income is received or accrued, we had supposed that the income tax collector is done with it, and that the way in which it is spent has not the slightest bearing on its taxability. To illustrate the startling results that the Commissioner's extreme position would entail, if Mobil owned the stock of a West German corporation manufacturing widgets in Frankfurt and selling them in various parts of Europe, and the management, control and direction of Mobil's investment in the widget manufacturer, and the receipt and disposition of dividends paid by that company were determined and controlled by Mobil entirely outside Vermont, we submit that it is unthinkable that the dividends would be includible in the apportionable base of an income tax imposed on Mobil by Vermont, on the ground that the dividends were used to build a filling station in Burlington or to purchase heating oil for sale to Vermonters. The only difference between the actual facts of the case before this Court and the hypothetical case is that the widget business and the petroleum business are obviously not part of a unitary enterprise. But that difference is made irrelevant to the instant case, because Vermont has eschewed the unitary apportionment method and has not apportioned Mobil's income on a combined basis with the dividend paying corporations. Consequently, given Vermont's apportionment of Mobil's income on a separate company basis, the only link between the foreign source dividends received from Mobil subsidiaries and affiliates and Vermont would be the use of the income in that State. That fact, accordingly, lays no greater foundation for inclusion of Mobil's foreign dividends in Vermont's apportionable base than would be the case with respect to the dividends from the widget manufacturer that are similarly expended.

[17] See Surrey, Warren, McDaniel and Ault, *Federal Income Taxation, Cases and Materials*, pp. 681-687 (1972 ed).

II.

The Vermont Statute Does Not Disallow Deductions Attributable to Dividends Excluded From the Apportionable Tax Base, as Was Established in the Proceedings Below in the Instant Case.

The Commissioner and some of the *amici* supporting his position contend that it would be improper to exclude Mobil's foreign source dividends from the apportionable base without disallowing the costs and expenses attributable to the holding and managing of the stocks. (Comm'r. Br. 18-19; Ill., Conn., Mass. and N.H. Br. 7, note 4). Whether or not such a rule would constitute wise tax policy, the Vermont law does not provide for such disallowance, as the Vermont court determined in the instant case.

A determination of Mobil's net income under the Vermont income tax law, with the dividends at issue excluded, had to be made by the Vermont Superior Court, since that tribunal had upheld the contention that the foreign source dividends were not includible in the apportionable base of the tax. (J.S. App. B, 14a-16a). The Superior Court, accordingly, remanded the case to the Commissioner for a redetermination of Mobil's tax in accordance with the decision (*Id.* at 16a). The redetermination was made by stipulation of counsel, on the basis of which the Superior Court entered its order establishing the amount of Mobil's tax liability for each of the years at issue. (J.S. App. B). Since the Commissioner had stipulated that Mobil's tax was thus properly determined under the Vermont law if the Superior Court was correct in its decision that the dividends at issue were not includible in the tax base, no question was raised at any point on the Commissioner's appeal to the Vermont Supreme Court that Mobil's tax as

thus determined was erroneous because of a failure to disallow as deductions the costs and expenses attributable to the stockholdings.

Moreover, the stipulated tax was properly determined under the Vermont law. The statute contains no provision for reducing the apportionable net income base by expenses or deductions attributable to dividends excluded from the base. (Br. App. A, 1a-3a). Although the statutes of some States disallow the costs and expenses attributable to income neither apportionable nor allocable to the State,[18] there are a number of States whose income tax laws, like the Vermont statute, contain no provision disallowing such deductions.[19] Accordingly, there is no basis for a contention before this Court that the foreign source dividends at issue should not be excluded from Mobil's Vermont income tax base without a disallowance of the costs and expenses attributable to the stockholdings.

[18] See Ark. Stat. Ann. §§84-2020.2, 3, CCH Ark. ¶¶94-549, 550; Haw. Rev. Stat. §235-5(c), CCH Haw. ¶11-035; S.C. Code §12-7-1120, CCH S.C. ¶12-435.

[19] See Mont. Rev. Codes Ann. §84-1502, CCH Mont. ¶10-301; N.H. Rev. Stat. Ann. §77-A:1, 3, CCH N.H. ¶¶15-060, 350; N.J. Rev. Stat. §§54:10A-4(K)-6, CCH N.J. ¶¶5-710, 805.

III.

The Contention That the Foreign Source Dividends Should Be Included in the Tax Base Because Mobil Will Otherwise Not Pay Taxes That Bear a "Fair Relationship" to the Benefits It Receives From Vermont Is Based on an Erroneous Assumption as to the Vermont Taxes Payable by Mobil and Seeks to Substitute the Commissioner's Judgment of "Fair Relationship" for the Legislative Determination Embodied in the Vermont Tax Structure.

The Commissioner makes the extraordinary contention that the foreign source dividends should be included in the apportionable base of the tax, because otherwise Mobil's tax for the three years at issue would be so small ("only $1178") as to "bear no fair relationship to the protections, opportunities and benefits provided by the taxing state or to the profits generated from business conducted in that state."[20] This contention is based on the fact that Mobil had substantial property and payroll and made substantial sales in Vermont. (Comm'r. Br. 19-20).

The trouble with this argument is that the Commissioner has substituted his own notions, albeit vague and undefined, as to what constitutes a "fair relationship" of the tax that should be paid for the "protections, opportunities and benefits provided by the taxing state", for the standards adopted by the Vermont Legislature. When the Legislature enacted *an income tax* on foreign corporations as a *quid*

[20] Comm'r. Br. 20. The figure of $1,178 used in the Commissioner's brief is inaccurate if it is designed to reflect Mobil's Vermont income tax liability for the years at issue with the dividends excluded from the apportionable tax base. The correct figure for Mobil's income tax for the three years is $4,155.90. See J.S. App. 17a.

pro quo payable for such benefits, it necessarily recognized that corporations would pay no income tax unless they realized profits, including profits that are attributable to the business carried on in Vermont, regardless as to whether they had substantial property, payroll and sales in the State. Consequently, the Commissioner's argument that the Vermont income tax would not bear a "fair relationship" to the benefits afforded Mobil by Vermont, because the exclusion of the foreign source dividends from Mobil's tax base would result in only a "small amount" of income tax, is both a *non-sequitur*, and an attempt by the Commissioner to substitute his own measure of "fair relationship" for that enacted by the Legislature.

The Commissioner's argument also suffers from the further defect that it assumes that the income tax is the only tax price Mobil pays to the State of Vermont for the benefits afforded by the State. That, of course, is a far cry from the facts, since Mobil is subject to a variety of other Vermont taxes as *quid pro quo* for the protections, opportunities and benefits it receives from the State. There are real estate taxes on land and buildings,[21] personal property taxes, including a tax on inventory[22] or alternative business personal property taxes.[23] Mobil is also subject to the Vermont tax on distributors of gasoline and other motor fuels sold in the State,[24] and to sales or use taxes on tangible personal property purchased for use in the State.[25]

[21] Vt. Stat. Ann. Tit. 32, §3001 *et seq.*, Vt. P-H ¶32,329, *et seq.*

[22] Vt. Stat. Ann. Tit. 32, §§3691, 4003 *et seq.*, Vt. P-H ¶¶32,410, 32,508 *et seq.*

[23] Vt. Stat. Ann. Tit. 32, §3617 *et seq.*, Vt. P-H ¶32,380 *et seq.*

[24] Vt. Stat. Ann. Tit. 32, §8801 *et seq.*, Vt. P-H ¶45,300 *et seq.*

[25] Vt. Stat. Ann. Tit. 32, §9701 *et seq.*, Vt. P-H ¶22,800 *et seq.*

IV.

Mobil's Activities as the Owner of Stocks and as the Recipient of Foreign Source Dividends Constitute Foreign Commerce.

The contention is made that Mobil's activities as the owner of the stocks of the corporations that paid the foreign source dividends at issue and the receipt by Mobil of dividends on the stocks did not constitute foreign commerce, and thus Mobil is not entitled to the protection of the Foreign Commerce Clause. (Comm'r Br. 25, MTC Br. 52-54). No case is cited in support of this contention, which appears to be based on the restrictive view of commerce expressed in *Paul* v. *Virginia* (75 U.S. [8 Wall.] 168, 183 [1868]) a century ago that "commerce" is limited to "subjects of trade and barter offered in the market", to "commodities to be shipped . . . from one State to another. . . ." That conception of what constitutes commerce has long since been repudiated. The Court, has instead, followed Chief Justice Marshall's view, as enunciated in *Gibbons* v. *Ogden* (22 U.S. [9 Wheat] 1 [1824]), that "Commerce, undoubtedly, is traffic, but is something more—it is intercourse. It describes the commercial intercourse between nations, and parts of nations, in all its branches." (*Id.* at 188).

In 1944, the Court repudiated *Paul* v. *Virginia* (*United States* v. *South-Eastern Underwriters Association* [322 U.S. 533]), and has gone on since then to hold that the conduct in more than one State of such enterprises as professional sports, the production, booking and presentation of theatrical productions, and the rendition of legal services all constitute interstate commerce.[26]

[26] *Radovich* v. *National Football League*, 352 U.S. 445 (1957); *United States* v. *International Boxing Club*, 348 U.S. 236 (1955); *United States* v. *Shubert*, 348 U.S. 222 (1955); *Goldfarb* v. *Virginia State Bar*, 421 U.S. 773 (1975).

Any possible question as to whether Mobil's activities as the owner of the capital stocks of some 400 foreign operating corporations (Stip. ¶¶10, 28-33, App. 82, 89-90), its management of the stocks, and its receipt annually of some $175,000,000 to $280,000,000 in foreign source dividends from the stocks (Ex. 8, App. 75-76) constituted foreign commerce, was put to rest by this Court's decision in *North American Co.* v. *SEC* (327 U.S 686 [1946]). There a public utility holding company with investments in companies doing business in a number of States, sought to invalidate §11(b)(1) of the Public Utility Holding Company Act of 1935 on the ground that it violated the Commerce Clause. In rejecting this contention, the Court stated:

> "The mails and instrumentalities of interstate commerce are vital to the functioning of this system . . . without them, [petitioner] would be unable to . . . exercise and maintain the influence arising from its large stock holdings, receiving notices and reports, sending proxies to stockholders' meetings, *collecting dividends and interest*, and transmitting whatever instructions and advice may be necessary." (*Id.* at 694, emphasis added).

The Court concluded that "the ownership of securities of operating companies . . . has a real and intimate relation to the interstate activities of holding companies and cannot be effectively divorced therefrom." (*Id.* at 702).

This language, the Court's holding and a host of other cases completely dispose of the contention that Mobil's activities as the owner of the stocks of its subsidiaries and non-subsidiaries and its receipt of the foreign source dividends at issue do not constitute foreign commerce. It is established that the scope of what constitutes "commerce" is the same whether the Court is dealing with the validity

of Congressional regulation or a challenge to State action as violative of the Commerce Clause; hence the Congressional regulatory cases are authority for our position. (See *Hughes* v. *Oklahoma*, 47 U.S.L.W. 4447, 4448, note 2 [Apr. 24, 1979]).

V.

The Contention That There Is No Substantial Risk of Multiple Taxation of Mobil's Foreign Source Dividends Is Not Supported by the State Laws.

One of the *amici* (but not the Commissioner) has challenged Mobil's contention that there is a substantial risk of multiple taxation because of the diversity of State apportionment and allocation methods (MTC Br. 70 *et seq.*; see Appellant's Brief ["App. Br."] 26 *et seq.*). The MTC brief comments only on the differences among the States in the treatment of dividends, ignoring Mobil's demonstration of the numerous differences in various other aspects of the State formulas.

With respect to dividends, the MTC brief comments on Mobil's table in which the diverse methods of allocating or apportioning dividends by 34 of the States (including the District of Columbia) that tax foreign source dividends are set out, 27 of which apportion some or all of the dividends (App. Br., Appendix B, p. 4a). However, the MTC brief comments only on 13 of the 34 States, leaving Mobil's analysis of the 21 remaining States unchallenged. (MTC Br. 72-75). An analysis of the statutes and regulations of those 13 States (see Appendix D annexed hereto p. 1a.), demonstrates that at most some minor refinements or qualifications in the classification of several of those States may be appropriate, but our essential contention as to the wide diversity in their methods of allocating and apportioning foreign source dividends remains unshaken.

That analysis shows that in seven States all taxable dividends are allocated to the commercial domicile (or the State of the business situs of the stock), in 19 States business income dividends are apportioned and non-business dividends are allocated to the commercial domicile, and in the remaining 8 States taxing foreign source dividends all dividends are apportioned. Consequently, the astonishing assertion of the MTC that "there appears to be an almost unanimous consensus among the states that all unitary income of a unitary trade or business" is to be apportioned (MTC Br. 75) must be dismissed as overstatement.

The diversity in the allocation and apportionment of dividends by the various States is illuminated by the fact that six of the seven States that allocate taxable dividends to the taxpayer's commercial domicile or to the business situs of the stock, did not join in any of the briefs *amicus* supporting the Commissioner. Those States include California and Louisiana, which are regular or associate members of the Multistate Tax Compact. Moreover, the filing in the instant case of a brief *amicus* supporting the Commissioner by another international oil company, Standard Oil Company of California, whose commercial domicile is located in California, emphasizes the reality of the diversity as between California's allocation of taxable dividends to the State of commercial domicile and Vermont's attempt to apportion taxable dividends. Nor is it without significance that 19 of the States plus the District of Columbia that tax foreign source dividends failed to join in briefs *amici* supporting Vermont's position.

VI.

Nothing Offered by the Opposing Briefs Has Shaken Mobil's Contentions That Under the Due Process Clause, Only the State of the Commercial Domicile or the Business Situs of the Stocks May Include the Dividends in Its Income Tax Base; and That Under the Foreign Commerce Clause, Such Foreign Source Dividends Should Be Held Taxable Only by the State of Commercial Domicile or the Business Situs of the Stocks.

A. *Neither the Authorities Nor Fiscal Policy Cited Warrant Apportionment of the Dividends at Issue to a State in Which the Taxpayer Does Not Maintain Its Commercial Domicile and in Which the Stocks Have Not Acquired a Business Situs.*

The Commissioner and his *amici* have challenged Mobil's contention that the State of a corporation's commercial domicile, or the business situs of the stock if it has attained a situs in another State, has the exclusive power to allocate dividends *in toto* to the base of its tax. (Comm'r. Br. 23-24; MTC Br. 78 *et seq*) It is contended that the doctrine of *mobilia sequuntur personam*, which "was developed in early inheritance and property tax cases," has "no discernible merit" "in the context of a tax on fairly apportioned net income" (Comm'r. Br. 23; see, also, Socal Br. 13), and that property tax cases, such as *Wheeling Steel Corp.* v. *Fox,* 298 U.S. 193 (1936) relied on by Mobil, are not relevant to the allocation or apportionment of income from dividends. (Socal Br. 13; MTC Br. 80-81).

We disagree. This Court has applied the commercial domicile and business situs rules to all aspects of the taxation of intangibles, including taxes on the privilege of doing business measured by the value of assets[27] and in-

come based taxes.[28] Moreover, the power of the State of a corporation's commercial domicile to allocate to its tax base all the taxable dividends of a corporation has been sustained by intermediate Federal and by State courts. (App. Br. 29-30).

The opinion of Mr. Justice Stewart, concurred in by Justices Powell and Stevens, in *California* v. *Texas* (437 U.S. 601 [1978]) is cited for the view that "the Court if ever faced with the problem of multiple taxation arising from State contacts would resolve the conflict by some method of apportionment rather than resort to a 'single correct' answer under state common law". (Comm'r. Br. 24, note 16). The opinion does not bear out this assertion.

In *California* v. *Texas* the Justices were unanimous in denying a motion by the State of California for leave to file an original bill of complaint to settle a dispute with the State of Texas over the question as to which State had the power to collect death taxes from the Estate of Howard R. Hughes. Mr. Justice Stewart's concurring opin-

[27] *Louisville & Jeffersonville Ferry Co.* v. *Kentucky*, 188 U.S. 385 [1903]. There, a Kentucky franchise tax levied on transportation companies and measured by the value of their franchises was set aside because there was included in the tax base the value of a ferry franchise granted by Indiana. The Court said:

> ". . . the ferry franchise derived from Indiana is an incorporeal hereditament derived from and having its legal *situs* in that State. It is not within the jurisdiction of Kentucky. The taxation of that franchise or incorporeal hereditament by Kentucky is, in our opinion, a deprivation by that State of the property of the ferry company without due process of law in violation of the Fourteenth Amendment of the Constitution of the United States . . ." (188 U.S. at 398).

[28] *New York ex rel. Whitney* v. *Graves*, 299 U.S. 366 [1937]. In this case the court upheld a New York income tax on the profits realized by a non-resident member of the New York Stock Exchange from a sale of a "right" to a one-fourth membership in the exchange, to which he became entitled as a member, on the ground that the membership had a "business situs" in New York.

ion, which reaffirmed the power of the State of the domicile of a decedent to impose a death tax on all his intangibles,[29] was concerned with the problem that arises when "there are sufficient contacts with each State to support a finding of domicile under each State's law".[30] After referring to a possible resolution of the conflict by "a division of the assets of the estate based on a judgment as to the relative strength of the domicile claims", Justice Stewart indicated his preference for a "neutral principle rather than attempt to determine a single 'correct' answer under state common law."[31] As we read this opinion, even in the double domicile death tax cases, the division of assets method—which would be analogous to formulary apportionment—is rejected and, instead, a preference is expressed for lodging the power of taxation in a single State.

Justice Stewart's observations were not directed to a tax such as the Vermont tax on Mobil's foreign source divi-

[29] "As will be developed more fully, *infra*, at 607-610, intangible personal property may, at least theoretically, be taxed only at the place of the owner's domicile. First National Bank v. Maine, 284 U.S. 312." 437 U.S. at 602, note 1.

[30] 437 U.S. at 613.

[31] The full statement of the opinion on this point reads as follows:

> "In deciding the controversy between Texas and California the Court could, of course, determine, according to its own rules of decision where Hughes was domiciled when he died, and permit only the State of domicile to tax the estate. Cf. Texas v. New Jersey, 379 U.S. 674. But assuming there are sufficient contacts with each State to support a finding of domicile under each State's law—a premise of jurisdiction in Texas v. Florida—the Court could with equal validity decide that the proper disposition was a division of the assets of the estate based on a judgment as to the relative strength of the domicile claims, or on almost any other basis that seemed just. Indeed, for purposes of this Court's resolution of a dispute between two sovereign States, each of which has an equally valid claim under its own law, it would seem more appropriate to decide the case on some neutral principle rather than attempt to determine a single 'correct' answer under state common law." *Ibid.*

dends, since admittedly Vermont is not a State of Mobil's domicile. Nevertheless, the opinion is another instance, in addition to those cited by Mobil (App. Br. 34 *et seq.*), in which Justices have indicated the appropriateness of resolving some types of multiple State tax claims by sanctioning taxation exclusively by a single State.

Quoting *in extenso* from an article of its counsel, the MTC brief (82-85) contends that fiscal policy considerations and the decided cases support State apportionment of dividends and income from other intangibles to the extent that the intangibles and the income they produce constitute integral parts of a unitary business conducted in part in the taxing State (MTC Br. Pt. 2, pp. 78-79). However, the unquoted portions of the same article make it evident that the argument supporting the apportionment of dividends depends on a pattern of operations that does not exist in the case at bar. For after analyzing the authorities, Mr. Dexter concludes:

> "These decisions lend credence to the proposition that intangible income should be assigned on the basis of the underlying corporate activities that originally give rise to the income and pursuant to which the intangible investments and income are used." Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations," 29 Vand.L.Rev. 401, 417-418 [1976]).

Since none of the "underlying corporate activities" of Mobil that "gave rise" to its foreign source dividend income took place in Vermont, the argument is inapposite to the instant case.[32]

[32] The MTC brief (p. 44) quotes from *Flint* v. *Stone Tracy Co.* (220 U.S. 107, 166 [1911]), to support its contention that States other than the commercial domicile or business situs may tax in-

(Footnote continued)

Moreover, MTC counsel has taken the position that as a matter of fiscal policy, if a business is unitary, combined apportionment is the appropriate method of taxation, as a consequence of which intercompany dividends would be eliminated from the tax base.[33] Although counsel for the MTC contends throughout his brief that the stocks of Mobil and the dividends they produced constituted integral parts of a unitary business, Vermont has not adopted the fiscal policy MTC counsel has espoused.

The Commissioner characterizes the *mobilia* doctrine as "anachronistic and economically unrealistic." (Comm'r. Br. 24). Mr. Justice Stone, who was not given to "anachronistic and economically unrealistic" positions, explained the wisdom of the doctrine by saying:

> "The resort to a fiction by the attribution of a tax situs to an intangible is only a means of symbolizing, without fully revealing, those considerations which are

come from intangibles. That case upheld the power of Congress to impose an excise tax on the privilege of doing business by corporations organized under the laws of the States, measured by their net income. The Court's statement, quoted by the MTC brief, that "Nor can it be justly said that investments have no real relationship to the business transacted by a . . . corporation" (220 U.S. at 166), was made in response to the contention that the "measurement of the tax by the net income of the corporation . . . received by it from all sources is not only unequal, but so arbitrary and baseless as to fall outside the authority of the taxing power" (220 U.S. at 165). Of course, Mobil does not contend that its income from investments has no relation to its business, but that the dividend income at issue does not have sufficient nexus to the business it carried on in Vermont to justify its inclusion in the Vermont apportionable tax base.

[33] "Of course, if the parent's control over the affiliated corporations results in the parent conducting a unitary business with the affiliated corporations, combined reporting should be required. This would eliminate intercorporate transactions between the combined group. The parent would exclude from its taxable income the intangible income it would receive from the combined affiliates." (Dexter, *op. cit. supra*, 413-414 note 36).

persuasive grounds for deciding that a particular place is appropriate for the imposition of the tax.

* * *

The economic advantages realized through the protection, at the place of domicil, of the ownership of rights in intangibles, the value of which is made the measure of the tax, bear a direct relationship to the distribution of burdens which the tax effects. These considerations support the taxation of intangibles at the place of domicil, at least where they are not shown to have acquired a business situs elsewhere, as a proper exercise of the power of government. Like considerations support their taxation at their business situs, for it is there that the owner in every practical sense invokes and enjoys the protection of the laws, and in consequence realizes the economic advantages of his ownership." (*First Bank Stock Corp.* v. *Minnesota,* 301 U.S. 234, 240-241 [1937]).

B. *The Principles Enunciated in* Japan Line *Point to the Limitation of the Power of Taxation of the Foreign Source Dividends to a Single State.*

The Commissioner's argument that *Japan Line Ltd.* v. *County of Los Angeles,* (47 U.S.L.W. 4477 [Apr. 30, 1979]) is not a precedent for the case at bar is based on an enumeration of factual differences between the two cases. (P. 24 *et seq.*). Of course, there are differences between a property tax on ship containers owned by non-U.S. corporations, based in foreign countries, and an apportioned income tax on dividends derived by a U.S. corporation from foreign sources, levied by a State which is neither the taxpayer's commercial domicile nor the business situs of the stocks. But those differences are not the crux of the matter. *Japan Line* stands clearly for two legal conclusions *that are the crux of the matter:* (1) the Foreign Commerce Clause prohibits the States, notwithstanding fair apportionment, from subjecting foreign commerce to substantial risks of multiple taxation; (2) the limitation of State taxation to a single taxing jurisdicton may be required to eliminate such multiple taxation. These principles, we suggest, point to a resolution of the multiple taxation risk of foreign source dividends of the character at issue in this case in the same manner as that adopted by the Court in *Japan Line,* by limiting the taxing power to a single taxing jurisdiction.

If the Court should accept that view, its choice as between (a) allocation of the foreign source dividends *in toto* to the taxpayer's commercial domicile or the business situs of the stocks, and (b) apportionment of the dividends to all the States in which the taxpayer does business, appears unmistakable. The claims to taxation by the commercial domicile or business situs are overwhelming, while the claims of the other States are without justification. Moreover, allocation of the dividends to a single State will avoid multiple taxation of foreign source dividends, whereas apportionment will not. The suggested rule also has the virtue of simplicity, the importance of which this Court recently recognized in dealing with other aspects of State taxation of commerce.[34] Finally, as in *Japan Line,* State tax apportionment of foreign source dividends would conflict with long established Federal policy, in this case the policy of eliminating double taxation of foreign source income and encouraging the payment of foreign dividends, whereas allocation of the dividends to a single State would be in harmony with Federal policy.

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[34] *Kosydar* v. *National Cash Register Co.,* 417 U.S. 62, 71 (1974).

VII.

There Is No Basis for the Spectres Raised by *Amici* That Other Types of Income or Property Would Be Placed Beyond the Taxing Powers of the States if Mobil's Contentions Should Be Upheld.

Amici (but not the Commissioner) contend that if Mobil's foreign source dividends cannot constitutionally be included in the Vermont income tax base, then it must follow that foreign source interest, royalties, and income from other intangible property will be removed from the taxing powers of the States, other than those of the commercial domicile of the owner of the property or the business situs of the intangible. (See MTC Br. 67-68; Ill., Conn., Mass., N.H. Br. 11-12). It is even argued that a decision favorable to Mobil in the case at bar will prevent the States from imposing property taxes on pleasure yachts owned by residents of the State and chartered to other residents, who cruise into foreign waters and make brief stopovers in foreign ports. (County of Los Angeles Br. 2). These sweeping assertions as to the consequences of a reversal of the Vermont Court are without merit. Each type of income or property presents its own tax problems, and may require resolution of a different character from that appropriate for the allocation or apportionment of foreign source dividends.

Thus, interest received by a corporation, whose commercial domicile is outside the taxing State, on securities in which it has invested funds not needed in its regular operations pending their use to acquire other businesses, which are held and managed entirely outside the taxing State, has been held not includible in that State's apportionable base. (*Sperry & Hutchinson Co.* v. *Department of*

Revenue, 270 Or. 329, 527 P.2d 729 [1974]). But interest on notes or accounts receivable arising from the sale of goods to customers is widely treated as operating income that is includible in the apportionable tax base.[35] And interest on funds invested in short term securities, acquired and held until the funds are needed in the corporation's regular business operations, has also been held to be apportionable. (*Sperry & Hutchinson Co.* v. *Department of Revenue, supra.*).

In the case of patent royalties, although the rule in some States is that "normally patents, trademarks, trade names, stocks and bonds and other intangibles have a situs for taxation at the domicile of the owner (Rainier Brewing Co. v. McColgan, 94 Cal. App. 2d 118; Miller v. McColgan, 17 Cal. 2d 432)", royalties, including those paid by foreign licensees, are apportionable to the various States in which a taxpayer conducts its business, where it is found that the royalties "constitute integral parts of the owner's regular business operations." (*Appeal of International Business Machines Corp.*, Calif. State Bd. of Equal. [1954], P-H Calif. Taxes on Corporate Income—Cases, ¶13,143.). The same principle has been applied to a book publisher's royalties from foreign sale of books. (*Appeal of Houghton Mifflin Co.*, Calif. State Bd. of Equal. [1946], *id.* at ¶13,060).

The crucial difference for State tax purposes between the income from intangibles treated as apportionable in the cases cited and Mobil's foreign source dividends is

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[35] That is the method used in the MTC apportionment and allocation regulations, IV 1(c)(3), P-H All States ¶6130, and it is recognized as proper by spokesmen for business organizations. See Peters, "The Distinction Between Business Income and Nonbusiness Income", Hearings on State Taxation of Interstate Commerce, Subcommittee on State Taxation of Interstate Commerce, Senate Committee on Finance, pp. 246, 253 (93rd Cong., 1st Sess., Sept. 18-19, 1973).

that the interest and royalties arose from the taxpayer's own operating functions, whereas Mobil's dividends arose from the operating functions of the corporations whose stocks it owned. As operating income of the taxpayer, the interest and royalties, even though from foreign sources, were properly includible in the taxpayer's apportionable base by each of the States in which the operating business was conducted, unless the apportionment is barred by the Foreign Commerce Clause. We have not employed the confusing and unrealistic distinction between business and nonbusiness income used by UDITPA because we agree with counsel for the MTC that: "The UDITPA distinction between 'business' and 'nonbusiness' corporate income *appears to lack any rational basis* and has created confusion for taxpayers and tax administrators alike." (Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations", 29 Vand.L.Rev. 401, 407 [1976]; emphasis added). The more appropriate and realistic distinction is the dichotomy of "operating" and "non-operating" income, which we have utilized.[36]

Consequently, a reversal of the Vermont decision in the case at bar would be relevant to the power of the States to apportion foreign source non-operating interest, royalties and the like, but not to the power of non-domiciliary, non-business situs States to include in their apportionable tax bases foreign source interest or royalties and other income that constitute the taxpayer's operating income.

That is because multiple taxation of foreign source operating income presents different problems, and requires

[36] Counsel for the MTC has recognized that "Dividend income to the payee corporation is a separate class of income from the income produced by the business activities of the payor corporation". (Dexter, *ibid.*). Similarly, the same dividends constitute to the payee a separate class of income from its own operating income.

a different type of judicial resolution from those involved in multiple taxation of foreign source non-operating income. In cases now pending in the State courts, taxpayers are contending that the application of the standard three factor formula to foreign operating income subjects them to risks of multiple taxation that are prohibited by the Foreign Commerce Clause.[37] They argue, *inter alia,* that the formula is inherently distorting as applied to foreign source income,[38] and that the inclusion of the foreign source operating income of the taxpayer (and its subsidiaries in States that employ the combined reporting method in determining the apportionable base and the factors) results in the misattribution to the States of income earned in foreign countries, and thereby subjects taxpayers to risks of multiple State taxation in violation of the Foreign Commerce Clause.[39]

If this Court should find merit in these contentions, in the event such cases come before this bench, it will be confronted with issues not presented by the case at bar. The Court may find it necessary to decide whether the *Moorman*

[37] *See, e.g., Container Corporation of America* v. *Franchise Tax Board,* Cal. Super. Ct. City and County of San Francisco, No. 673-492, unpublished opinion sustaining the assessment, Sept. 11, 1979; *Mobil Oil Corporation* v. *Franchise Tax Board,* now pending in the Cal. Super. Ct. City and County of San Francisco, No. 723-863.

[38] The apportionment formula is based on the premise that a dollar of wages, property or sales in each taxing jurisdiction will produce at least roughly the same amount of profit as in each of the other jurisdictions in which the income is derived.

Taxpayers contend that because wages are markedly lower in foreign countries than in the United States and the other factors vary significantly, and profitability is substantially higher in foreign countries than in the United States, the apportionment method misattributes foreign source income to the States.

[39] See note 38, *supra.*

case doctrine of non-intervention in the diverse methods of apportionment of taxable income should be extended to foreign source operating income; and whether, as taxpayers argue, the application by a State of the apportionment method to foreign source income conflicts with Congressional regulation of foreign commerce, including the general rejection by Congress under the Federal income tax law of the apportionment method and its prescription instead of separate accounting for determining United States source income, as distinguished from foreign source income. (*Ibid.*).

In the instant case there is no need to decide whether the *Moorman* principle is applicable to foreign source operating income, or whether separate accounting is required to be used by the States in taxing corporations deriving operating income from foreign commerce. Instead, the case at bar can be disposed of without passing on those questions by holding, as Mobil contends the Court should hold, that the avoidance of multiple taxation requires a restriction of the jurisdiction of the States to tax foreign source dividends of the character at issue to the recipient's commercial domicile or the business situs of the stock. Accordingly, such a decision by this Court that the Vermont tax violates the Foreign Commerce Clause would have no bearing on the taxation, apportionment or allocation of operating income derived from foreign sources; it would be relevant only to the treatment of non-operating income.

The most extreme spectre conjured up by *amici* is to be found in the brief filed by the County of Los Angeles. There it is suggested that Mobil's arguments, if upheld, would "cause large pleasure yachts owned by California residents, chartered to California residents, but stopping for 2 days in Vancouver, to escape California taxation

because of the 'power' of Canadian officials to levy taxes there." (P. 2). We are at an utter loss to understand how the County of Los Angeles has been able to persuade itself that Mobil's contentions have any bearing on the power of the State of California to impose property taxes (which we understand the county to be concerned with) on the pleasure yachts in question.

The case at bar presents its own problems, to which we have devoted our argument. The Court's observation in *International Harvester Co.* v. *Department of Treasury* (322 U.S. 340, 348 [1944]), that "It will be time to cross that bridge when we come to it", is the proper answer to each of the spectres sought to be raised in the instant case by the briefs *amici*.

VIII.

In the Silence of Congress, Apportionment of Foreign Source Dividends by All the States in Which the Recipient Corporation Is Taxable Would Be Neither Constitutional Nor an Acceptable Resolution of the Issue in This Case.

In Socal's brief *amicus*, it is asserted that counsel for Mobil, in testimony before a Senate Finance Subcommittee, supported the propriety of apportioning dividends received from corporations that are part of the unitary business. (Pp. 10-11). In that testimony, it was stated that:

> "the realistic and fiscally sound tax treatment of such an enterprise [a unitary manufacturer and its sales subsidiary] is to combine or consolidate the income of the parent and selling subsidiary for purposes of unitary apportionment. The dividend issue would then

disappear, since the dividends would be eliminated as an intercompany item." [40]

The testimony went on to state:

"If, however, neither the State nor the taxpayer exercises the option granted by the type of statute which it is assumed would be in force to utilize the combined or consolidated approach, or, if for one reason or another, the taxpayer does not qualify under the statutory provision for combination, the character of the dividend income on a separate parent company basis, nevertheless, does not, in my thinking, change; it is still operating income which ought to be apportioned in taxing the recipient." [41]

The Senate hearings related to bills pending before Congress to regulate State taxation of interstate commerce.[42] The recommendations referred to were made in that context, and were directed to the type of legislation which counsel believes that Congress ought to enact, and not to the power of the States to tax in the silence of Congress. The enactment of Federal legislation would create "a whole new ball game" and make possible solutions to the plaguing problems of State taxation of interstate and foreign commerce that are beyond the powers and province of this Court under the Constitution.

If Congress were to regulate State tax allocation and apportionment of income, including dividends derived from

[40] Testimony of Jerome R. Hellerstein, Hearings on State Taxation of Interstate Commerce, Subcommittee on State Taxation of Interstate Commerce, Senate Committee on Finance, p. 163 (93rd Cong., 1st Sess., Sept. 18, 1973).

[41] *Ibid.*

[42] The major bills being considered were S.1245, the Mathias-Ribicoff-Humphrey bill and S.2092, the Magnuson bill. *Id.* p. 4.

foreign commerce, the legislation could both broaden and restrict the existing State power of taxation of income from foreign commerce.[43] The legislation would undoubtedly require the States to apply uniform methods of allocation or apportionment, at least on a basis elective by the taxpayer.[44] And it is believed by counsel whose testimony has been cited that Congress can, by enacting such legislation, empower the States to include in the apportionable measures of their income taxes foreign source dividends received by a taxpayer from corporations that are part of its unitary business.[45] Such a statute would, doubtless,

[43] The broad powers of Congress to regulate State taxation affecting the commerce were affirmed in *Prudential Insurance Co.* v. *Benjamin*, 328 U.S. 408 (1946). For a survey and analysis of the sweeping powers of Congress to regulate interstate commerce, see Stern, "The Commerce Clause and the National Economy: 1933-1946", 59 Harv.L.Rev. 883 (1946). *Cf.* also, the denial of review of a State court decision upholding P.L. 86-272, 73 Stat. 55, under which Congress restricted State taxation of interstate commerce. *International Shoe Co.* v. *Cocreham*, 246 La. 244, 164 So. 2d 314 (1964), cert. denied *sub nomine Mouton* v. *International Shoe Co.*, 379 U.S. 902 (1964).

[44] This has been true of all the major bills dealing with the area that have been before Congressional Committees in recent years. See §201, S. 1245 and §301, S. 2092, note 42 *supra*, and §301, S. 2173, 95th Cong., 1st Sess. 12 (Mathias bill), introduced Oct. 4, 1977.

[45] Although the question has not arisen, there is basis in the decisions of this Court for the view that the type of legislation under discussion would be within the power of Congress under Section 5 of the 14th Amendment, the Enabling Clause, coupled with the plenary power of Congress to regulate foreign commerce, regardless of whether there would have been adequate Due Process nexus between the taxing State and the dividend income in the absence of Congressional regulation. See *Katzenbach* v. *Morgan*, 384 U.S. 641 (1966) and the analysis of that case in L. Tribe, American Constitutional Law, §5-14 p. 265 *et seq.* (1978); and Professor Paul A. Freund's reference to the powers of Congress under both the Commerce Clause and the Enabling Clause of the 14th Amendment in discussing the possible establishment by Congress of an administrative commission that would take over the function of resolving State tax apportionment and allocation questions. "Umpiring the Federal System", 54 Columbia L.Rev. 561, 571 (1954).

likewise prohibit the State of a corporation's commercial domicile or of the business situs of the stock from allocating in full to its tax base foreign source dividends received from corporations that are part of the taxpayer's unitary business.[46] The result of such Congressional regulation would be that dividends derived from unitary corporations operating in foreign commerce would be subject to State taxation on an apportioned basis, under a uniform formula, by the various States in which the business operates, but that multiple taxation of the dividends would be eliminated.

Such a solution is not, however, possible by decision of this Court unaided by Congressional legislation. First, it is submitted that there is no warrant under the Due Process Clause or the Commerce Clause, so long as Congress remains silent, for this Court to deny to the State of a taxpayer's commercial domicile (or to the State of the business situs of the stock if the stock has acquired a situs outside the holder's commercial domicile), at which the stocks and the dividends they produce are managed and controlled, the power to allocate foreign source dividends *in toto* to its tax base. (See App. Br. Point II.E.). Second, *Moorman* made explicit the fact that this Court has neither the constitutional authority nor the institutional capacity to prescribe a national, uniform code of apportionment. (*Id.* at 37).[47] Consequently, a decision of this Court sustaining the Vermont dividend apportionment would exacerbate the risks of multiple taxation of dividends from foreign commerce, in view of (a) the resulting power of all the States in which a taxpayer does business to apportion the dividends and the concomitant power of the State of the taxpayer's commercial domicile or the business situs of the stock, to allocate the dividends, and (b) the wide diversity of State allocation and apportionment methods used by the various states. As Professor Paul A. Freund has observed:

> "The Court has the power to allow or disallow state taxes but not to alter or set terms, and the mesh of its net is consequently coarse." [48]

So long as Congress remains silent, there does, however, lie within the "mesh" of the Court's "net", the power to which the decisions under the Due Process Clause and the Commerce Clause, State taxing tradition and policy considerations all point, namely, that the power of the States to tax foreign source dividends (and to tax them in full) lies solely in the State of the taxpayer's commercial domicile, or the business situs of the stock if it has acquired a situs in another State.

[46] See §§207-208, S. 1245, §306, S. 2092, and §302, S. 2173, all note 44 *supra*.

[47] See, also, Black, Frankfurter and Douglas, J.J. dissenting in *McCarroll* v. *Dixie Greyhound Lines*, 309 U.S. 176, 188-189 (1940), *(Footnote continued)*

and Frankfurter, J. dissenting in *Northwestern States Portland Cement Co.* v. *Minnesota* and *T.V. Williams, as State Revenue Commissioner* v. *Stockham Valves and Fittings, Inc.*, 358 U.S. 450, 476 (1959).

[48] See *op. cit.* note 45 *supra*, 54 Columbia L.Rev. at 569.

CONCLUSION

In view of the foregoing and the reasons set forth in Appellant's Brief, the decree of the Vermont Supreme Court should be reversed, with directions to set aside the assessment to the extent that foreign source dividends have been included in the apportionable base of the tax at issue.

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Respectfully submitted,

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APPENDIX

APPENDIX D

Analysis of Allocation and Apportionment of Dividends By States Whose Classification in Appendix B to Appellant's Brief Has Been Challenged.

California, Montana; Idaho, Kansas; Oregon and Colorado: The MTC asserts that "presumably all the dividends in question would be eliminated" in the States named because those States apply the combined method of apportionment to unitary businesses. MTC. Br. 72. However, no State treats as part of the unitary business a corporation in which the taxpayer holds less than 50% of the stock. Consequently, except in California which allocates all taxable dividends to the State of commercial domicile, the large amounts of dividends at issue that were received by Mobil from United States or foreign incorporated non-subsidiaries would be subject to the apportionment rules of the above mentioned States. See App. 76.

As for California, that State's regulations provide that most dividends are to be allocated to the taxpayer's commercial domicile; the only exception stated is the case of taxpayers whose principal business actually is dealing in securities; such dividends are apportioned. Reg. 25120, P-H Calif. ¶11,536-L.60. Counsel for the MTC has elsewhere recognized that California allocates dividends to the State of commercial domicile. See Dexter, "Taxation of Income from Intangibles of Multistate-Multinational Corporations", 29 Vand.L.Rev. 401, 416-418 (1976).

Standard Oil Company of California, whose commercial domicile is located in that State, is currently challenging the allocation to California of its dividend income, including foreign source dividends (see *Appeal of Standard Oil*

Co. of California, State Board of Equalization and Socal Br. at 2), contending that the dividends should be apportioned. It is for that reason the company has filed a brief *amicus* in the case at bar supporting the Commissioner's postion.

Mississippi: Contrary to counsel's assertion (MTC Br. 74), the Mississippi statute makes it clear that most dividends are allocable to the commercial domicile or business situs. "Business income derived from intangible property of any kind or nature shall be treated as income from sources within this state, if the evidence of ownership of such property has acquired a business, commercial or actual situs in this state. Business income derived from unitary multi-state activities which cannot be allocated to any state shall be apportioned to this state by use of formulas prescribed by the commissioner." Miss. Code Ann. §27-7-23(c)(2)(B)(ii), CCH Miss. ¶12-430. Moreover, the Mississippi regulation provides: "The income allocable to specific states shall include interest income, dividends, capital gains on the sale of property not used or employed in the unitary business, . . . or any other income wholly earned within some specific jurisdiction or jurisdictions." Reg. 1.27-7-23(7), CCH Miss. ¶12-435.

Arizona: That the table in Mobil's Appendix properly lists Arizona among the States allocating taxable dividends to the commercial domicile (or to the business situs), despite the MTC's assertion that this classification is erroneous (MTC Br. 72, 74), is shown by that State's regulations:

> "In the case of foreign corporations which have not acquired a commercial domicile within this State, income from intangible personal property is income from sources within this State only if the property has a business situs here.
>
> . . .
>
> Some examples of income which ordinarily is to be considered as nonapportionable are as follows: . . . (2) Interest on bonds, dividends on stock and other income from intangibles." Reg. §135-8(a), (b), CCH Ariz. ¶ 12-406.

Minnesota, Oklahoma and Louisiana: As to the three States named, whose classification as allocating all dividends to the commercial domicile has been challenged (MTC Br. 73-74), some refinements or qualifications with respect to the classification may be appropriate.

The Oklahoma statute provides that income from "interest, dividends" and other intangible property "shall be allocated" to the commercial domicile of the taxpayer or to the business situs of the property if the income is not part of a unitary business. Okla. Stat. Tit. 68, §2358A, CCH Okla. ¶ 12-425.

The Minnesota regulations provide that "The income from intangible personal property ordinarily follows the domicile of the recipient except where such property is employed in the business of the taxpayer and such business does not consist principally of the holding of such property and the collection of the income and gains therefrom." Reg. §2017(2)(b), CCH Minn. ¶ 12-408.

The Louisiana statute provides that dividends "shall be allocated to the state in which the securities . . . producing such income have their situs, which shall be at the business situs of such securities . . . if they have been so used in connection with the taxpayer's business as to acquire a business situs, or, in the absence of such a business situs, shall be . . . at the commercial domicile of the

taxpayer in the case of a corporation; provided that dividends upon stock having a situs in Louisiana received by a corporation from another corporation which is controlled by the former, through ownership of 50% or more of the voting stock of the latter, shall be allocated to the state or states in which is earned the income from which the dividends are paid, such allocation to be made in proportion to the respective amounts of such income earned in each state. . . ." La. Rev. St. §243, CCH La. ¶ 12-411.

North Carolina and South Carolina: The MTC asserts that the table erroneously classifies South Carolina as a State which allocates all dividends to the commercial domicile of the payee corporation (MTC Br. 72). That classification is correct, as is clear from the statute.

"The following items of income shall be specifically and directly allocated in accordance with the following provisions before apportionment of the remaining net income and such items shall not be included in any factor of the apportionment formula:

. . .

(2) Dividends received from corporate stocks owned, less all related expenses, shall be allocated to the state in which the principal place of business of a corporation is located. . . ." S.C. Code §12-7-1120, CCH S.C. ¶ 12-435.

The MTC brief assumes that North Carolina is treated in the table as allocating all income to the commercial domicile. MTC Br. at 74-75. That is erroneous; the State is classified in the table as allocating non-business dividends and apportioning business dividends.